Pay leverage, not percent of pay in equity, is the key measure of corporate director pay

May 18, 2026

The objectives of corporate director pay are much the same as the objectives of corporate executive pay: provide strong incentives to increase shareholder value, retain key talent, and limit shareholder cost

The conventional wisdom in executive pay is that the three basic objectives can be achieved by combining median target pay with a high percent of pay at risk. The conventional theory is that a high percent of pay at risk provides a strong incentive, not letting target pay fall below the peer median retains key talent and not letting target pay rise above the peer median limits shareholder cost. These principles have become widely embraced in corporate director pay over the last thirty years.

The rise of equity-based director pay

For U.S. S&P 1500 directors, the average percent of pay in equity has risen from 27% in 1997 to 59% in 2025, and the variation in percent of pay in equity has fallen by almost half. In addition, pay levels have increasingly converged around market pay, measured as average director pay for companies of the same revenue size in the same industry. For U.S. S&P 1500 directors, the standard deviation of the log difference from market pay declined from 0.70 in 2002 to 0.31 in 2024.

Given these changes in director pay, we would expect to see strong and consistent director incentives. If a director has 60% of his wealth in stock and 40% in cash, a 1% increase in shareholder wealth would increase the director's wealth by 0.6%. The ratio of percent change in director wealth to percent change in shareholder wealth, 0.6, is what we call wealth leverage. Directors and investors tend to think that 60% of pay in stock provides a similar incentive to 60% of wealth in stock, but, in fact, it provides an incentive that is much more varied and often much weaker.

Measuring pay leverage

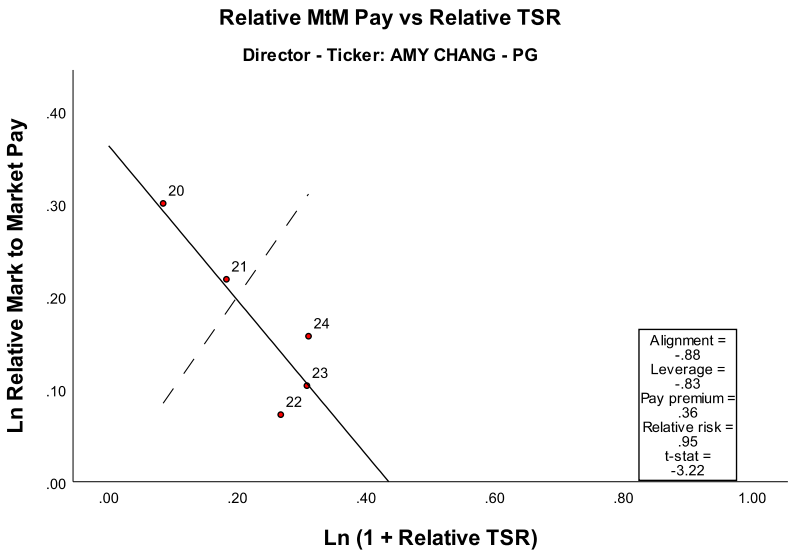
We can use the sensitivity of cumulative pay value to cumulative TSR to measure the incentive provided by director pay plans. Pay leverage is the ratio of the percent change in cumulative pay – measured on a "mark to market" basis at each year-end – to the percent change in cumulative shareholder wealth. To test the assumption that percent of pay in equity is a good proxy for pay leverage, we measured pay leverage for 20,462 directors with percent of pay in equity falling in a narrow range – 55% to 65% – using five-year periods ending in 2011-2025. We found that 10% had pay leverage below -0.11 and 25% had pay leverage below 0.17. The median pay leverage was only 0.41, well below our expectation of 0.6. But, in the same sample, many had pay leverage well above our expectation of 0.6. 25% were above 0.66, and 10% were above 1.0.

Contrasting examples: Amy Chang and Gay Evans

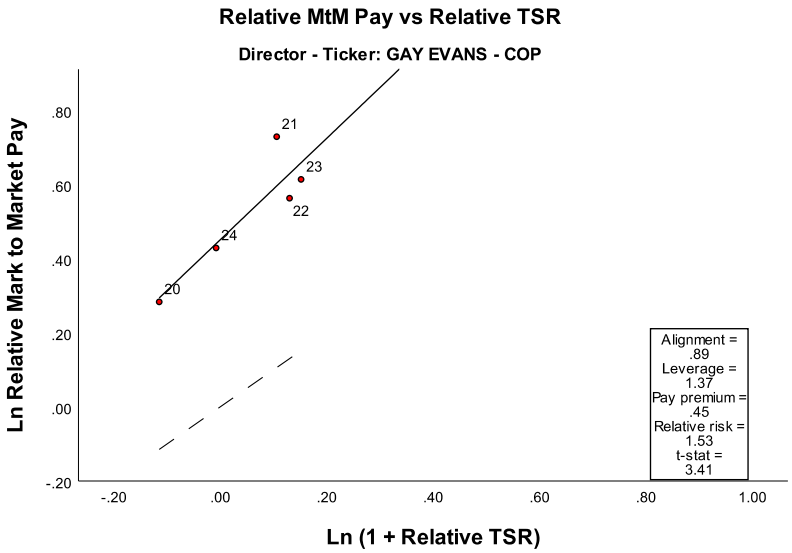
Figures 1 and 2 show pay leverage scatterplots for 2020-2024 for two directors, Amy Chang of Proctor & Gamble and Gay Evans of Conoco Philips. Both have pay leverage that is very different from their percent of pay in equity. Chang's average percent of pay in equity for the five years was 63%, but her pay leverage is -0.83. Evans's average percent of pay in equity was 61%, but her pay leverage is 1.37. In each scatterplot, the vertical axis shows cumulative mark-to-market pay, and the horizontal axis shows cumulative TSR.

Cumulative mark-to-market pay for Chang and Evans for a year is the sum of the cumulative cash retainer from 2020 to the year, plus the year-end value of the stock shares granted from 2020 to the year. To capture the director's incentive, that is, pay sensitivity to company, not industry, performance, we adjust the company's TSR for industry TSR and adjust the director's mark to market pay for cumulative market pay. Market pay is the average pay of directors in a company of the same revenue in the same industry.

2020 inflation-adjusted market pay is $338,000 for Chang and $311,000 for Evans. We don't increase market pay for subsequent increases in revenue so we don't lose the pay leverage that is correlated with revenue increases. We use log scales on each axis to capture the assumption that a 1% change in relative shareholder wealth causes a constant percentage change in relative pay.



Solid line is the director trendline. Dashed line is leverage = 1.0 with pay premium of zero



Solid line is the director trendline. Dashed line is leverage = 1.0 with pay premium of zero

Figures 1 and 2 show four additional pay dimensions captured by the scatterplots: pay alignment (the correlation of relative pay and relative TSR), the log pay premium at industry average performance (a measure of performance-adjusted cost), relative pay risk, and the pay leverage t-statistic.

Why conventional pay structures fail

Why do Chang and Evans have pay leverage that is so different from their percent of pay in equity? We can get some insight from prior research that tells us there is a simple pay plan with annual grants of performance shares that provides pay leverage of 1.0 with perfect pay alignment. This perfect correlation pay plan differs from conventional pay practice in four ways. First, 100% of pay is in stock. Second, target pay is not market pay but market pay adjusted for trailing relative performance.

Setting target pay equal to market pay regardless of past performance creates a systematic "performance penalty" that reduces leverage and alignment. High stock returns are penalized with a reduction in grant shares (to avoid exceeding target pay), and poor stock returns are rewarded with an increase in grant shares (to maintain target pay).

Third, stock vesting takes out the industry component of the stock return; that is, the vesting multiple is 1/(1 + the industry return from the date of grant). Fourth, any cash paid out prior to the end of the measurement period is treated as a draw against the value of the performance shares; in other words, in our context, all stock is held throughout our five-year measurement period and doesn't vest until the end of the five-year period.

Reducing the percent of pay in stock reduces leverage but leaves pay alignment nearly perfect. If all directors had a cash retainer equal to 40% of their initial stock grant value and equity compensation that followed the provisions of the perfect correlation pay plan, director pay leverage and alignment would fall in a very narrow range.

Simulating an improved compensation model

Simulations using 106,462 director five-year periods ending in 2011-2025 show that director pay leverage would be 0.60, with 0.47 at the 10th percentile and 0.70 at the 90th percentile. Pay alignment would be 0.98 or more for all but 1% of directors. Chang would have pay leverage of 0.65 and pay alignment of 1.00. Evans would have pay leverage of 0.60 and pay alignment of 1.00.

Rethinking director compensation

Director pay, over the last 30 years, has converged to the same conventional wisdom that rules executive pay: a high percent of pay at risk, combined with target pay set at the peer median, achieves the three basic objectives of executive and director compensation. The simple structure of director pay makes it easy to see that the conventional wisdom is flawed. Pay leverage should be tightly clustered around the percent of pay in equity, but shows enormous variation due to two bad policies: setting target pay at market regardless of past performance, and failing to take out the industry component of the stock return. To understand the consequences of those bad policies, directors, compensation consultants, proxy advisors, and institutional investors need to shift their focus from percent of pay in equity to pay leverage and alignment.